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June 17, 2008

AGENDA ITEM 3

TO: MEMBERS OF THE PERFORMANCE AND COMPENSATION COMMITTEE

I. SUBJECT: 2008-2009 Performance Plans for the Interim Chief Executive Officer, Chief Actuary, General Counsel, Interim Chief Investment Officer and Her Direct Reporting Staff (First Reading)

II. PROGRAM: Administration

III. RECOMMENDATION: Approve the First Reading of the 2008-2009 Performance Plans for the Interim Chief Executive Officer, Chief Actuary, General Counsel, Interim Chief Investment Officer and Senior Investment Officers

IV. ANALYSIS:

The Board of Administration's Compensation Policies and Procedures include a schedule for approving incentive plans for the coming fiscal year. The 2008-2009 performance plans for the Interim Chief Executive Officer, Chief Actuary, General Counsel, Interim Chief Investment Officer and Senior Investment Officers are presented with this item for first reading.

Quantitative Measures - Investment Management Performance Plans

Substantive changes have been made in the performance plans of the investment management positions for Real Estate, AIM and Global Equity as follows:

Real Estate

On September 10, 2007, the Investment Committee approved the Strategic Plan for the real estate program. One of the recommendations contained in the Strategic Plan was to revise the overall Real Estate portfolio benchmark. The Real Estate staff has worked with the Board's Real Estate Consultant to address this issue and to develop a more meaningful portfolio benchmark.

The revised benchmark is a blend of the National Council of Real Estate Investment Fiduciaries Property Index ("NPI"), weighted at 90%, and the FTSE EPRA NAREIT Global Total Return Real Estate Index, weighted at 10%. The blended benchmark has been introduced to take into account the fact that a material component of the portfolio is invested in global publicly traded real estate securities.

The NPI is a quarterly time series composite total rate of return measure of investment performance of a very large pool of commercial real estate assets acquired in the private markets for investment purposes only. All properties have been acquired on behalf of tax-exempt institutional investors. Returns presented in the NPI are for un-leveraged core properties in the United States on a gross of fees basis using market value accounting standards.

The FTSE EPRA NAREIT Global Total Return Real Estate Index is a series designed to track the performance of real estate companies and Real Estate Investment Trusts ("REITs") that are publicly traded. The FTSE EPRA NAREIT Global Total Return Real Estate Index includes securities from 26 different countries in Asia, Europe and North America.

This information is also provided in the revised Investment Policy for Equity Real Estate that will be presented during the June Investment Policy Subcommittee.

AIM

The AIM staff worked with the Board's General Pension Consultant as well as the Board's Private Equity Consultant to evaluate the effectiveness of the existing benchmark.

There are two benchmarks for the AIM Program identified in Policy; a long term benchmark and a short term benchmark. The long term benchmark is the Wilshire 2500 ex-tobacco plus 300 basis points over a 10 year rolling average period. The short term benchmark is the median return of the Venture Economics Custom Young Fund Universe. The benchmark currently used for incentive compensation purposes is the short term benchmark.

The incentive compensation benchmark in AIM has been in place for approximately 7 years and has not changed over that time period. Over the same period, the AIM Program has matured and performance has increasingly exceeded the benchmark. Because of the continuing maturity of the AIM Program and consistent out-performance over the benchmark, it was prudent to reevaluate the benchmark.

The proposed new benchmark is the market weighted Venture Economics Young Fund Universe ranking. There are two changes inherent in this benchmark versus the old benchmark. First, the benchmark would no longer be the median return. It would shift to CalPERS' overall ranking within the Venture Economics Young Fund Universe. Second, the benchmark would no longer be weighted by AIM's sub-asset class exposures. Rather, the new benchmark would be market weighted.

The rationale for the new benchmark is that it raises the bar from the median return to higher rankings within the Venture Economics universe, and it also measures Staff's ability to make sector/strategy bets (e.g., buyouts, venture capital, mezzanine, distressed securities, etc.), which was previously not the case.

Global Equity

At the December 2007 Investment Committee meeting, changes to the Plan's asset allocation and the structure of the Global Equity program were adopted. The implementation of these changes carries a potentially significant cost resulting from asset turnover. It is a normal procedure to isolate such expenses from the performance metrics attached to individual programs. This treatment is warranted by recognizing that the turnover and attendant cost are not resulting from the ongoing management process, but rather due to decisions taken to improve the overall strategic posture of the Plan. The Board's General Pension Consultant concurs with this approach.

The FY 2008-09 performance plans being presented for Global Equity reflect a change to exclude the impact of the transition expense stemming from the actions adopted at the December 2007 Investment Committee meeting. The exclusion of these expenses is facilitated by removing certain Global Equity transition accounts from the listing of accounts consolidated into the Global Equity incentive compensation composite (GLOBLIC). The excluded transition accounts will be consolidated within the Total Fund composite (SJ1CA1).

In December 2007, the Investment Committee was informed of the rationale for excluding the impacts of the change to the Global Equity benchmark that resulted from the new asset allocation policy from the incentive compensation calculations. The basis for the exclusion is due to two factors. The first being the shift to a global-based and away from the current domestic-based benchmark would have significant costs. The second was an acknowledgement that the decision was mandated by the Investment Committee's asset allocation process and not staff. Therefore, staff should not bear the brunt of the costs.

The performance plans for Global Equity presented for FY 2008-09 are based on a modified calculation methodology for the Global Equity incentive compensation composite (Globlic). In general, the costs related to the transition to the new benchmark are excluded from Globlic and applied directly to the Total Fund composite (SJ1CA1).

The attached letter dated June 5, 2008 from Wilshire Consulting provides their comments regarding the quantitative measures in the plans as required by the policies and procedures. A representative of Wilshire will be available to respond to any questions. Also attached are letters from the Board's investment consultants for Real Estate, AIM, and Global Equity commenting more specifically on each of the methodology revisions explained above.

Qualitative Measure - Investment Management Performance Plans

Placeholder language for the qualitative leadership performance measures has been included in the plans of the investment management positions. Human Resources staff is working with the Interim Chief Investment Officer to develop more meaningful and measurable leadership objectives which will be presented in the plans for second reading.

V. STRATEGIC PLAN:

Under Goal II of the Strategic Plan, CalPERS is committed to sustaining a high performance work culture. Under Goal IV, the organization is dedicated to effectively utilizing its resources, including a diverse, creative, motivated, high performance workforce. This can be accomplished at the highest executive levels through the establishment of methods that provide broad flexibility in the recruitment, retention and compensation of key personnel.

VI. RESULTS/COSTS:

The establishment of performance plans is critical to the management of a competitive compensation program for executives at the highest levels of the organization. This, in turn, is critical to the success of the organization. The cost of performance awards that might arise from the recommendations in this item will be funded from existing resources.

Chris O'Brien, Chief
Human Resources Division

Gloria Moore Andrews
Deputy Executive Officer, Operations

Attachments

Performance and Compensation Committee
June 17, 2008

2008-2009 Performance Plans for the
Interim Chief Executive Officer, Chief Actuary, General Counsel,
Interim Chief Investment Officer and Senior Investment Officers

Performance plans for the 2008-2009 Fiscal Year for the Interim Chief Executive Officer, Chief Actuary, General Counsel, Interim Chief Investment Officer and Senior Investment Officers are presented for first reading on the following pages:

Position	Current Incumbent
Interim Chief Executive Officer	Ken Marzion
Chief Actuary	Ron Seeling
General Counsel	Peter Mixon
Interim Chief Investment Officer	Anne Stausboll
Senior Investment Officer, Alternative Investments	Leon Shahinian
Senior Investment Officer, Asset Allocation	Farouki Majeed
Senior Investment Officer, Fixed Income	Curtis Ishii
Senior Investment Officer, Global Equity	Eric Baggesen
Senior Investment Officer, Real Estate	Theodore Eliopoulos